State Board of Equalization

Economic Perspective

Summary of Recent Economic Developments *July 1999*

❖ *U.S. Economic Developments*

Early 1999 Economic Growth Rate Called Unsustainable

Real GDP rose 4.3 percent in the first quarter of 1999, according to the final revised estimate released in late June by the U.S. Department of Commerce. This continues a trend, as real GDP growth has averaged four percent per year during the past three years. In his June 17 testimony before Congress, Federal Reserve Board (Fed) Chairman Allan Greenspan indicated that he thinks the noninflationary maximum growth rate is about 3 percent. Quoting from Dr. Greenspan's testimony, "Overall economic growth during the past three years has averaged four percent annually, of which roughly two percentage points reflected increased productivity and about one point the growth in our working age population. The remainder was drawn from the ever decreasing pool of available job seekers without work. That last development represents an unsustainable trend…"

The pool of available workers referenced in Dr. Greenspan's testimony above is also called the labor force. A generalized definition of the labor force is the population over age 16 who are either working or looking for work. Examples of people over age 16 not in the labor force include persons on active duty in the armed forces, retirees, spouses choosing not to work for pay, many full-time students, and many of the disabled. Approximately one-third of the adult population (over age 16) are not in the labor force. Many of these people could be in the labor force if they wanted to be, but for various reasons choose not to. On a year-by-year basis, the labor force includes adults who decide to join the work force and those who turn age 16 that year.

A major indicator of the pool of available workers referred to above is the U.S. unemployment rate. The rate measures the proportion of the population over age 16 that are looking for work, but are unemployed. The unemployment rate has steadily declined over the past three years, from an average of 5.6 percent of the labor force in 1995 to an average of 4.3 percent for the first six months of 1999. The unemployment rate is an imprecise measure of the productive capacity of the economy because the labor force (the denominator in the unemployment rate) fluctuates with economic activity. Strong economic growth, as we have had for several years, tends to draw more people into the labor force because of associated good job opportunities and higher wages. For example, the labor force increased by 1.8 percent in 1997, nearly twice as fast as its long term average of about one percent. However, labor force growth slowed in 1998; it increased by only 1.0 percent. This growth rate is identical to the long term average, and down sharply from the 1997 increase. If labor force growth is to increase much faster than one percent per year, it is likely to require relatively large increases in wages. These increases in wages are necessary to induce more people who are considering entering the labor force to do so. Such wage increases are likely to be inflationary.

Fed Increases Key Interest Rate

Reflecting these concerns, the Fed increased its key interest rate by 0.25 percent on June 30. Specifically, the Fed increased the target for the federal funds rate, the rate for funds which banks charge to lend to each other overnight, from 4.75 percent to 5.0 percent.

Steady Payroll Employment Growth

In other recent economic developments, nonagricultural payroll employment increased by an average of 195,000 employees per month from April through June. In percentage growth terms, this average increase is about the same as the average nonagricultural payroll employment gains of 209,000 jobs per month from January through March. Stated alternatively, nonagricultural payrolls increased approximately 0.2 percent per month in each of these two quarters. (Sources: (1) U.S. Department of Commerce, STAT-USA Economic Bulletin Board; (2) "Testimony of Chairman Allan Greenspan, Monetary Policy and the Economic Outlook, Before the Joint Economic Committee, U.S. Congress, June 17, 1999; (3) U.S. Council of Economic Advisors, *Economic Indicators*, May 1999.)

❖ *California Economic Developments*

Strong Employment Growth Continuing

Similar to the U.S. economy, the California economy has continued to experience above average growth so far in 1999. One of the most comprehensive measures of economic well being available for states on a timely basis is nonagricultural employment. For the first six months of 1999, California nonagricultural employment increased 3.8 percent when compared to the first six months of 1998. This growth rate is slightly above the average annual 1998 growth rate of 3.5 percent, which was the fastest employment growth the state has had in the 1990s.

Falling Unemployment Rate

The California unemployment rate stood at 5.3 percent in both May and June. These rates are down from 5.7 percent in April, and are the lowest monthly rates since 1990. After peaking at 9.4 percent in 1993, the California annual average unemployment rate has declined steadily. The state's unemployment rate averaged 5.9 percent in 1998 and 5.6 percent for the first six months of 1999. While much lower than in the early 1990s, the state's unemployment rate has continued a 1990s pattern of being well above the U.S. unemployment rate. The first-half

California rate of 5.6 percent is more than one percent higher than the U.S. first-half 1999 average rate of 4.3 perent.

Strong Taxable Sales Gains in Early 1999

The Board of Equalization's preliminary estimate shows that taxable sales increased 8.8 percent in the first quarter of 1999 compared to the first quarter of 1998. This is the fastest growth in taxable sales since the first quarter of 1996. The first quarter 1999 growth rate is also much stronger than annual growth rates of the last two years. According to the preliminary estimates, annual taxable sales rose 5.3 percent in 1998 and 6.2 percent in 1997. (Sources: California Employment Development Department, "Interim Industry Employment," *Labor Market Conditions in California, July 9, 1999*, Board of Equalization news release # 36, July 1, 1999.)

❖ *A Review of Economic and Revenue Impacts of California Travel*

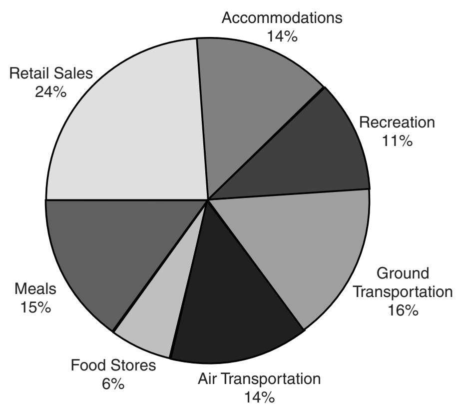
As many people travel in California on vacation this summer, few will probably think about the economic impacts of their traveling. However, travel and tourism are very important activities to the California economy. The California Trade and Commerce Agency Division of Tourism defines travel as any trip that is not of a commuting nature where the destination is more than 50 miles from the traveler's home. The Division of Tourism estimates that travel spending in California was $64.8 billion in 1998, about 6 percent of gross state product. Travel-related activities are estimated to have accounted for 685,000 California jobs in 1998, more jobs than the state's construction industry.

Most "person trips" in California are made by California residents, about 80 percent of the state's total number of trips. U.S. out-of-state travelers accounted for 16 percent and international travelers made the remaining 4 percent of all person trips. About 70 percent of domestic travel in the state is for leisure purposes and 30 percent is for business travel. Travelers spend an average of over $80 per person per day (excluding transportation spending).

The chart on the following page shows a breakout of this average travel spending for 1998. As shown in the chart, travel spending is spread over a surprising variety of economic activities. As one may expect, transportation spending accounts for 30 percent of the average travel dollar (16 percent on ground transportation and 14 percent on air transportation). However, the largest single category of travel spending is for retail sales, 24 percent of average travel spending. Much of this spending is for gifts, souvenirs, and other items. Spending on restaurant meals is 15 percent of total travel spending, about the same as the percentage spent on accommodations (14 percent). The rest of the travel dollar is spent on recreation (11 percent) and food stores (6 percent).

Travel spending also has significant impacts on state and local revenues, particularly for sales taxes. If the retail, restaurant, and ground transportation sales shown in the chart on the right are combined, they account for about 55 percent of all travel spending. The majority of this spending is subject to state and local sales taxes. The Division of Tourism estimates that state and local sales tax revenues related to travel spending totaled approximately $2.1 billion in 1998. Of this amount, they estimate that state sales tax revenues comprised $1.6 billion and local sales tax revenues $0.5 billion. These sales represent about 9 percent of total 1997-98 California taxable sales. In addition to sales taxes, the Division of Tourism estimates that state motor vehicle fuel excise tax revenues related to travel spending were $520 million in California in 1998. This figure is about 20 percent of total 1997-98 California motor vehicle fuel tax revenues. (Sources: (1) *California Tourism Fast Facts*, California Trade and Commerce Agency Division of Tourism, April 12, 1999. (2) *California Travel: The Impact of Travel,* California Trade and Commerce Agency Division of Tourism, March, 1999. (3) *California Spring Travel Forecast*, California Trade and Commerce Agency Division of Tourism, February, 1999. (4) *State Board of Equalization 1997-98 Annual Report,* March 1999.)

Average 1998 California Travel Spending by Type of Business



Source: California Trade and Commerce, *California Travel*, March 1999.
Does not include travel arrangements.

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